EBOOK

How to increase profits for your construction business.

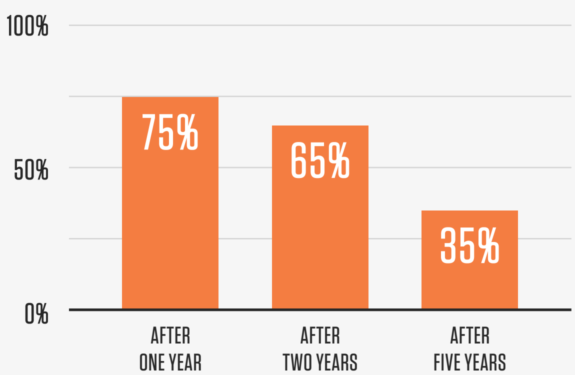
Where profits go wrong and how to make them right.

PROCORE®

The construction industry is one of the world's fastest-growing industries, and increasing demand for new hospitals, schools, and roadways continues to boost construction output.

In fact, construction volume is estimated to increase by 85% by 2030—reaching $15.5 trillion—accounting for close to 60% of all global growth.

CONSTRUCTION BUSINESS SURVIVAL RATES



Despite its rapid growth, the industry has one of the lowest survival rates. Only about 75% of construction businesses survive their first year, about 65% make it through their second year, and only about 35% make it through their fifth year.

If demand is high, why do so many construction businesses fail?

The reality is, construction requires high upfront investment and cost. With general contractors bringing in an average pre-tax net profit of 1.4–2.4%, one bad job could result in financial collapse. Too often businesses succumb to the volatility of low profit margins, inadequate equity, and poor cash flow management.

But running a business doesn't have to feel like constantly being on the brink of make-or-break. Staying profitable is simply a matter of knowing what to track and making adjustments when necessary. By carefully monitoring key numbers affecting profit margins, you can ensure your business not only survives, but thrives both now and in the future.

Contents

01

Plan your profit.

“WE WANT TO BE MORE PROFITABLE NEXT YEAR.”

Sound familiar? While many businesses hope to see their margins grow year after year, too often these goals aren’t actionable. What exactly does “more profitable” look like? Is that 10%, 15%, or 20% more profitable—and is that net or gross?

Begin by asking yourself:

+ What was our profit goal last year?
+ Did we accomplish that goal?
+ How did that impact our goal for this year?

Knowing where you're going from the get-go will make it a lot easier to figure out how to get there. Setting specific profit goals not only helps align your team toward a common objective, but it also helps you determine what your net profit mark-up should be.

On a yearly basis, determine the annual gross and net profit you want to make. To do this, calculate your company's equity and overhead for the coming year, and then factor in any liabilities that could affect your bottom line.

Once you have your yearly goal, review your progress on a monthly basis. Do you need to bid on more jobs? Increase markup? Decrease overhead? If you're not hitting your monthly profit goals, make the necessary adjustments to get back on track.

KEY TAKEAWAY:

Each year, set specific gross and net profit goals, and regularly track your progress.

02

Know your worth.

Knowing how much your company is worth is key to staying out of the red and in the black—not to mention growing your business. To calculate your company's equity, take its total assets and subtract total liabilities.

The next step is to determine your company's Return on Equity (ROE). This measures how much profit a company generates with the money that's invested in it. When compared to the industry average, it can serve as a helpful indicator of a company's profitability. Experts suggest that an ROE of 15–25% is generally considered healthy. Use the formula below to determine your ROE.

ROE = ANNUAL NET PROFIT / EQUITY

KEY TAKEAWAY:

Know your company's ROE, and aim for 15–25%.

03

Keep the lights on.

Before you even think about hitting your profit goals, you need to know how much money you need to cover your expenses, or overhead. This refers to all your fixed costs of doing business including office supplies, printing costs, utilities, salaries, and employee benefits. Once you determine what your costs will be, track your progress throughout the year. Just like a personal budget, if you're spending far more than you make, you know something needs to change.

One way to track how much your overhead is contributing to the success of the business is to identify your total annual Return on Overhead (ROOH). Like ROE, it can serve as a helpful indicator as to how your investment (in this case, your overhead) is doing compared to other investment benchmarks.

At the beginning of each year, determine what your projected overhead expenses will be for the next 12 months. Then use the following formula to identify your company's ROOH. Experts suggest general contractors should typically aim for a pre-tax net profit return on their annual overhead expenses of 25–50%.

ROOH = ANNUAL NET PROFIT / OVERHEAD

KEY TAKEAWAY:

Know your company's ROOH, and aim for a pre-tax net profit return on annual overhead of 25–50%.

04

Strategize sales volume.

Now that you know what your overhead expenses are and how much profit you want to make, you can easily identify what your sales volume should be for the year in order to cover both. Use the helpful formula below to calculate your company's total sales volume, and don't forget to track your numbers on a monthly basis.

TOTAL SALES VOLUME =
GROSS PROFIT GOAL $ / GROSS PROFIT %

KEY TAKEAWAY:
Determine what your sales volume should be in order to cover your overhead and hit your profit goals.

Markup vs. Margin

It’s important to note the difference between markup and margin; using them interchangeably could mean leaving a lot of money on the table. Markup is the percentage of money added to direct costs to cover overhead and profit. Margin, on the other hand, is the difference between direct costs and sales price divided by the sales price. Use the formulas below to calculate the two:

MARKUP % = MARKUP $ / COST
MARGIN % = MARKUP $ / SALES

For example, if a job costs $1,000 and the sales price is $1,300, the markup is $300, or 30%. The margin, however, would only be 23%.

05

Calculate true job costs.

Before the bidding process takes place, you need to know how much the project is going to cost in the first place. This goes beyond simply calculating materials used or hours worked.

When calculating field labor costs, consider employees' burden rates and fringe costs such as health insurance, vacation, training, profit sharing, and overtime. This will help ensure better estimates and more accurate bids.

In addition, you'll want to calculate how much your equipment costs annually. This includes the purchase price, interest, insurance, maintenance, and gas. You can then use this to determine how much you should charge per hour to use them on a job.

KEY TAKEAWAY:

Know what your job costs to build. Make sure to include field labor fringe costs and equipment costs.

06

Make a computer do the work for you.

At first glance, tracking so many numbers can seem overwhelming. But you don't have to do it alone. Using construction management software helps you easily track your numbers with accurate and up-to-date information while reducing the burden of tedious administrative work, freeing up your team to focus on more meaningful tasks. What's more, it also provides helpful dashboards and reports for insights on profits, cash, accounts receivable, liabilities, and debts.

In doing so, you can monitor your progress and make adjustments in real time. Instead of tracking projects independently, you'll get a more holistic view of both past and present jobs so you can better plan for future ones.

KEY TAKEAWAY:

Invest in construction management software to help you easily monitor progress. Utilize reports and dashboards to identify areas of improvement and make adjustments when necessary.

07

So what will it be: sink or swim?

Knowing your numbers is one thing, but data is useless unless you know what to do with it. Creating benchmarks throughout the year allows you to regularly spot areas of improvement so you can course correct before it's too late. Set aside time on a weekly or monthly basis—even if it's only an hour—to see if you're on track to hit your year-end goals.

This will make jobs more financially predictable and help create a cushion in the event of unforeseen costs. In doing so, you'll not only protect yourself against potential financial risk, but you'll also maximize profit margins. That means a more stable business and more money in your pocket both now and in the future.

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